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No. 77-1172

In the Supreme Court of the United States

OCTOBER TERM, 1977

NATIONAL MUFFLER DEALERS ASSOCIATION, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The opinion of the district court (Pet. App. B, pp. 8a-15a) is not officially reported. The opinion of the court of appeals (Pet. App. A, pp. 1a-7a) is reported at 565 F. 2d 845.

JURISDICTION

The judgment of the court of appeals (Pet. App. C, pp. 16a-17a) was entered on November 21, 1977. The petition for a writ of certiorari was filed on February 18, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether petitioner, a non-profit corporation whose membership consists entirely of muffler dealers franchised by a single muffler manufacturer, is exempt from federal income tax as a "business league" under Section 501(c)(6) of the Internal Revenue Code of 1954.

STATUTE AND REGULATIONS INVOLVED

Section 501(a) and (c)(6) of the Internal Revenue Code of 1954 (26 U.S.C.) and Treasury Regulations on Income Tax, Section 1.501(c)(6)-1 (26 C.F.R.), are set forth in the Appendix, *infra*, pp. 1a-2a.

STATEMENT

Petitioner was organized in 1971 under the New York Not-For-Profit Corporation Law as a trade association for muffler dealers franchised by Midas International Corporation. At that time, there was a contest for control of Midas, and many of Midas' franchisees formed petitioner in order to establish a united group to deal with the new Midas management. Since petitioner's organization, all of its members have been Midas franchisees, and petitioner has never attempted to recruit dealers who were not Midas franchisees (Pet. App. A, pp. 2a-3a; Pet. App. B, pp. 8a-10a).

Petitioner's principal activity has been to serve as a bargaining agent for its members in their collective dealings with Midas. Petitioner gained recognition by Midas as a representative of its franchisees, negotiated a franchise agreement more favorable to the franchisees, and persuaded Midas to eliminate the requirement that customers pay a service charge when seeking to replace a guaranteed Midas muffler. Petitioner also holds an annual convention, at which issues of concern to Midas dealers are discussed, maintains two insurance programs for its members, and publishes a newsletter (Pet. App. A, p. 3a; Pet. App. B, pp. 10a-11a).

The Internal Revenue Service rejected petitioner's application for tax exempt status as a "business league" under Section 501(c)(6) of the Code. After the Service denied petitioner's claims for refund of $5,357 in taxes for the years 1971-1973, it instituted this suit in the United States District Court for the Southern District of New York (Pet. App. B, pp. 8a-9a).

The district court found that there was no evidence that petitioner benefited the muffler industry as a whole or muffler dealers as a group. As the court observed, "[petitioner's] newsletter and other information are disseminated only to Midas dealers, and its bargaining activities, which constitute its most important function, are for the benefit of Midas dealers alone" (Pet. App. B, p. 11a). Since petitioner's activities were not directed at the improvement of business conditions in "one or more lines of business," as Treasury Regulations, Section 1.501(c)(6)-1, require, the court held that petitioner was not entitled to tax exemption as a business league (Pet. App. B, pp. 11a-14a).

The court of appeals affirmed. In its view, the requirement of the Regulation that a tax-exempt business league devote itself to the improvement of conditions in "one or more lines of business" was reasonable because it insured that the exemption would benefit the general economic welfare rather than private interests (Pet. App. A, pp. 5a-6a).

DISCUSSION

Section 501(c)(6) of the Internal Revenue Code of 1954 provides an income tax exemption for "[b]usiness leagues, chambers of commerce, real-estate boards, [and] boards

of trade * * *." Although the Code does not define the term "business league," Treasury Regulations, Section 1.501(c)(6)-1, state in pertinent part as follows:

> A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. *Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.* * * * [Emphasis supplied.]

The court of appeals held that "[t]he admittedly common characteristic of the organizations enumerated in § 501(c)(6) is that they foster well-being within a broadly-defined segment of the commercial sector" (Pet. App. A, p. 5a). It therefore properly concluded that in enacting Section 501(c)(6), Congress intended "to provide an exemption for organizations which promote some aspect of the general economic welfare rather than support particular private interests" (*ibid.*). In the court of appeals' view, the "line of business" requirement of the Regulations is "well suited to assuring that an organization's efforts do indeed benefit a sufficiently broad segment of the business community" (*ibid.*; footnote omitted).

Petitioner does not challenge the court of appeals' conclusion that it does not meet the "line of business" requirement of the Regulations. Unlike a chamber of commerce or a board of trade that draws its membership from one or more lines of business, petitioner's members are all franchisees of Midas

International Corporation. Moreover, petitioner's activities do not benefit the muffler industry as a whole but are solely directed to serve the interests of the Midas dealers in their relationship with Midas International. The court of appeals therefore correctly held that petitioner was not entitled to tax-exempt status under Section 501(c)(6) and the "line of business" requirement of the Regulation.

However, petitioner argues (Pet. 10, 17-18) that the decision below conflicts with *Pepsi-Cola Bottlers' Ass'n, Inc.* v. *United States*, 369 F. 2d 250 (C.A. 7). There, a divided panel held that an organization of bottlers of a particular soft drink qualified as a tax-exempt business league despite the fact that its activities were solely directed toward promoting the interests of Pepsi-Cola bottlers rather than the soft drink industry as a whole. Although the court did not expressly invalidate the "line of business" requirement of the Regulation, it concluded that the organization "cannot be disqualified merely because its members all bottle a particular soft drink product" (369 F. 2d at 252). We agree with petitioner that the Seventh Circuit's holding cannot be reconciled with the decision below.[1] Indeed, in rejecting petitioner's claim to tax-exempt status, the court below stated that "[t]o the extent that our holding is in disagreement with the Seventh Circuit's decision in *Pepsi-Cola Bottlers' Assn.* v. *United States*, 369 F. 2d 250 (7th Cir. 1966), we decline to follow the majority opinion in that case" (Pet. App. A, p. 5a n. 1).

Moreover, the Internal Revenue Service advises that the question has some administrative importance. Although there are no pending court cases presenting the

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[1]The Service has announced that it will not follow the *Pepsi-Cola* decision. See Rev. Rul. 68-182, 1968-1 Cum. Bull. 263.

issue, the Service is currently considering 13 ruling applications in which organizations that do not extend membership to an entire line of business are seeking classification as tax-exempt business leagues. It is important that a uniform rule be established to guide the tax bar and the Treasury alike. Accordingly, we do not oppose the petition for a writ of certiorari.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MAY 1978.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS. CERTAIN TRUSTS, ETC.

(a) [as amended by Sec. 101(j)(3), Tax Reform Act of 1969, 83 Stat. 526] *Exemption From Taxation.*—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * * * *

(c) *List of Exempt Organizations.*—The following organizations are referred to in subsection (a):

* * * * *

(6) [as amended by Sec. 6(a), Act of November 8, 1966, 80 Stat. 1515] Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

* * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.501(c)(6)-1. *Business leagues, chambers of commerce, real estate boards, and boards of trade.*

A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not

to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax. Organizations otherwise exempt from tax under this section are taxable upon their unrelated business taxable income. See part II (section 511 and following), subchapter F, chapter 1 of the Code, and the regulations thereunder.